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C O N F I D E N T I A L SECTION 01 OF 03 BEIJING 000895

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SUBJECT: GANSU ECONOMY GROWING, BUT MORE INVESTMENT NEEDED:
AMBASSADOR'S MARCH 10 DINNER WITH GANSU PARTY SECRETARY

Classified By: Ambassador Clark T. Randt, Jr. for reasons 1.4 (b) and (d).

SUMMARY

1. (C) Gansu Province has benefited from Central Government initiatives to balance development by boosting spending in western China, but it continues to face major challenges, including water and power shortages, low rates of foreign investment, lagging employment opportunities, and a decrease in Central Government funding, said Provincial Party Secretary Lu Hao during a March 10 dinner hosted by the

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Ambassador. Lu expressed concern about inflation and the effects of tightening monetary policy on investment in the province. He underscored the important role of the private sector in transforming Gansu's state-owned enterprises (SOEs) and encouraged U.S. businesses to invest in Gansu. Lu welcomed the establishment of Virtual Presence Post Lanzhou and urged the expansion of people-to-people exchanges between the United States and Gansu. END SUMMARY.

ECONOMY GROWING BUT INCOME GAP REMAINS

2. (C) The Ambassador hosted a March 10 dinner for Gansu Party Secretary Lu Hao, who was in Beijing to attend the National People's Congress (NPC). Party Secretary Lu told the Ambassador that Gansu's GDP grew 12.1 percent in 2007, slightly above the national GDP growth rate of 11.4 percent. This marked the eleventh year in a row that Gansu Province GDP growth topped 11 percent. He said he remains concerned, however, that despite Gansu's gains, the income gap between western China and coastal provinces continues to widen as Central Government funding under the Great Western Development Program is gradually decreasing. Lu said that during the NPC, he urged Premier Wen Jiabao and other leaders to offer more assistance, particularly in the form of fiscal transfer payments and increased Central Government spending on rural health care, education and infrastructure. Premier Wen participated as a member of the Gansu delegation in this year's NPC, which gave Gansu an advantage in advocating its proposals, Lu added.

INFLATION, MONETARY POLICY REMAIN TOP CONCERNS

3. (C) Lu said he was encouraged by Premier Wen's strong

commitment to balanced development in the Government Work Report but expressed concern about the effects of the People's Bank of China's (PBOC's) tight monetary policy on loan growth in 2008. For western China, crucial investment is affected when loans become less readily available, he said. On inflation, Lu remarked that food prices remain high but real estate prices in Gansu are low relative to other parts of the country, making it somewhat easier for Gansu's middle-class urban residents to absorb higher prices. Nonetheless, Lu said he remains concerned that rising global energy and commodities prices could contribute to longer-term inflation. He argued that China should keep inflation below 4.8 percent in order to maintain a healthy economy.

SEEKING MORE U.S. INVESTMENT

14. (C) Lu welcomed closer economic ties between the United States and China, noting that globalization has brought about growing interdependence between the two countries.

U.S.-invested projects in Gansu have been very successful, and Gansu wants to attract more U.S. investors, he explained.

In 2007, Gansu had 232 U.S.-invested projects in progress, primarily in power generation, real estate development, chemicals, oil drilling and the export of seeds. Lu said that although trade between the United States and Gansu Province has grown by a large margin over the past five years, total bilateral trade volume remains low relative to U.S. trade with China's coastal provinces.

MOVING BEYOND A STATE-CONTROLLED ECONOMY

15. (C) Gansu's economy remains dominated by SOEs, with an emphasis on heavy industry, Lu said. Currently, private firms account for only 40 percent of Gansu's total registered companies. Private investment is rising, particularly in the

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services sector, but the contribution of SOEs remains much higher in Gansu than in wealthier provinces. Lu explained that Gansu is making broad efforts to upgrade primary industries. Foreign investors could play a valuable role in these efforts. Lu remarked that the operations of National Oilwell Varco, an American company with a factory in the province that produces oil industry equipment, provide a good example of cooperation between a private foreign investor and a Gansu SOE. Other potential areas for cooperation include the development of wind power generation facilities in western Gansu.

SOME PROGRESS MADE IN ADDRESSING WATER SHORTAGES

16. (C) The primary impediment to Gansu's development remains resource shortages, especially the lack of water. Lu said the province has been investing increasing amounts of money in water transfer to provide residents of dry areas with access to clean drinking water over the long term. Lu reported that the Central Government has been instrumental in addressing this problem and noted that some 2 million Gansu residents now have safe drinking water as a result. Desertification in the Hexi corridor remains a top concern. Lu stated that in 2007 the Central Government invested RMB 4.75 billion (USD 670 million) in efforts to relocate farmers, return farmland to forest and improve irrigation to combat desertification in the province.

WIND-POWERED SCIENTIFIC DEVELOPMENT

17. (C) In support of President Hu's concept of scientific development, Lu said, Gansu aims to increase its economic growth without harming the environment. Currently, Gansu derives over 70 percent of its power from coal-fired plants, but it has plans to change the mix of energy sources in the

near future. Lu said that with the support of the Central Government, Gansu is developing what officials hope will become the world's largest wind power facility. He explained that when completed, the facility, located in western Gansu, will deliver power to major cities in central and western China. Lu projected that by 2015, the facility will be capable of producing more than 10 gigawatts at full capacity. (Comment: A typical mid-sized U.S. power plant produces 300-400 megawatts at full capacity. Producing 10 gigawatts as early as 2015 using alternative energy sources such as wind appears quite ambitious and could be considered an unrealistic goal. End Comment.) Major challenges also remain in connecting the power generated to the national grid. Lu pointed out that although it is relatively easy to harness wind power, it is difficult to transport the electricity from a remote part of the province to populated areas.

BUILDING A HARMONIOUS SOCIETY THROUGH MIGRATION

18. (C) Lu explained that years of economic reform have brought great benefits to the country but they have also resulted in unbalanced growth. To build a harmonious society, Lu said, the government must find ways to help people who have been left behind, including rural residents and those laid off as a result of SOE reform. The gap between rich and poor in Gansu is also continuing to widen. Gansu currently has a labor surplus, and approximately 5 million of its residents work in China's more developed coastal cities. This outward migration has led to an increase in remittances, which benefit family members who stay behind in Gansu. Lu noted that over 7,000 young Gansu women work as nannies in Beijing, while an additional 400 Gansu residents are employed by a Beijing-based Panasonic plant.

LANZHOU VIRTUAL PRESENCE POST WELCOME

19. (C) The Ambassador highlighted Embassy efforts to establish a Virtual Presence Post (VPP) in Lanzhou. Lu welcomed the VPP and assured the Ambassador that Gansu Provincial Foreign Affairs and Commercial Affairs offices, both of which were represented at the dinner, would be pleased to assist VPP officers. Lu remarked that people-to-people exchanges between Gansu and its U.S. sister state, Oklahoma, have proliferated in recent years. Programs, including educational exchanges and medical training opportunities in the United States for Gansu

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physicians, have been well-received. He urged further expansion of such programs, which he said have benefited the people of Gansu.

RANDT